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May 9, 2008

Ernest Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Dear Mr. Johnson:

As you may know, the Colorado Public Utilities Commission has opened an investigatory docket to look at incentives for gas and electric utilities under current rate-of-return regulation to see if these incentives are producing behavior consistent with the Commission's policy goals. The investigation would also examine alternative forms of regulation and explore whether alternative incentives could potentially achieve better results.

Some of the issues to be addressed in the Colorado PUC's investigation are: how adjustment clauses affect utility incentives, whether regulatory incentives could be changed to align a utility's financial incentives with energy efficient investment, and the incentives involved in competitive bidding and utilities' buy-or-build decisions.

These are questions this Commission should also consider; therefore, I request that a generic docket be opened to investigate these issues. I have attached the Colorado PUC's order so that it may serve as a template for our own inquiry into utility incentives. I particularly look forward to a discussion on adjustor mechanisms and surcharges which can increase customers' bills outside of a rate case. These have become common in recent years. This was not always the case. For example, APS did not have a power supply adjustor from 1989 to 2005 and TEP does not currently have one. Prior to the proliferation of such adjustor mechanisms and surcharges, utilities would have to bear the risk of increased fuel and purchased power costs between rate cases. With an adjustor mechanism, most of this risk is shifted to utility customers.

Given the phenomenal growth that our state has been experiencing as well as the series of rate increases that customers have had to bear, I believe that the time has come to seek creative solutions. We need to take a look at Commission policies and explore alternatives.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink that reads "William A. Mundell".

William A. Mundell, Commissioner
Arizona Corporation Commission

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 08I-113EG

IN THE MATTER OF THE INVESTIGATION OF REGULATORY AND RATE INCENTIVES
FOR GAS AND ELECTRIC UTILITIES.

**ORDER OPENING INVESTIGATORY
DOCKET AND NOTICE OF INQUIRY**

Mailed Date: April 29, 2008
Adopted Date: March 26, 2008

I. BY THE COMMISSION

A. Statement

1. On February 21, 2008, the Commission held a deliberations meeting in which we identified and discussed a set of policy initiatives that we intend to pursue over the next year or more. One of those initiatives concerns incentives faced by the energy companies we regulate. We find that there is a need for greater understanding, by the Commission and its Staff, of the following: (1) the manner in which the existing regulatory structures and incentives influence energy utilities' behaviors; (2) the extent to which these incentives align results with Commission policy goals; (3) the manner in which alternative regulatory structures and incentives for these utilities may impact their actions; and (4) the extent to which these alternative regulatory structures may achieve results consistent with Commission policy goals.

2. As part of our deliberations on March 26, 2008, we began with a discussion of the purpose of such an investigation. We clarified that the purpose of such an investigation is to focus on utility incentives, with the goal of addressing customer-side incentives in a separate forum as part of other Commission initiatives. We also found that the scope of our investigation

should be broad enough to assess both the existing incentives for utilities inherent as part of the current regulatory paradigm (*e.g.*, rate-of-return/cost of service with varying adjustment clauses) as well as an understanding of other regulatory paradigms (*e.g.*, alternative forms of regulation, price-cap index regulation). We also discussed our vision of the process that includes participatory conversations about these issues with all stakeholders interested in these issues.

3. In addition, we discussed our expectations as to the likely outcomes of the investigation. While we cannot predict what the specific outcomes will be, possible outcomes include any or all of the following: a report from Commission Staff (Staff) summarizing the conclusions from the investigations; recommendations for rule changes; recommendations for possible legislative policy changes; and a formal record that could be included in other Commission proceedings.

4. We also discussed the priority and timing of the investigation, noting that a reasonable time for conclusion of the investigation was the end of 2008, prior to the next legislative session and contemporaneous with the expected filing of a general rate case by Public Service Company of Colorado.

5. An initial list of questions and issues were identified to assist in defining the scope of the proceeding. The questions include:

- i. What basic incentives does today's regulatory structure (*e.g.*, rate-of-return regulatory structure, adjustment clauses, test year determination, depreciation policies) provide to Colorado electric and gas utilities?
- ii. What are the alternatives to the Rate Base-Rate of Return model?
- iii. How do adjustment clauses affect utility incentives?
- iv. What are the alternatives to adjustment clauses?
- v. Can the regulatory incentive structure be changed to align a utility's financial incentives with energy efficiency investment?
- vi. Can the incentive structure be modified to heighten the utility's incentives for management efficiency?

- vii. Should the Commission consider an electric “decoupling” mechanism?
- viii. Can the regulatory incentive structure be altered to change the stakes for a utility making a build-or-buy decision?
- ix. What impact does the current regulatory structure regarding the buy-or-build scenario have on competitive bidding as a tool in resource selection?
- x. What is the state of the art across the nation?

The Commission understands that the outcomes of the investigation should apply prospectively, and not affect related issues that are addressed by current proceedings.

6. Additional impetus for this investigation has been provided by Governor Ritter’s Executive Order D 004 08, issued on April 28, 2008. In relevant part, the Executive Order provides:

Greenhouse Gas Emissions from the Utility Sector:

I hereby request that the PUC require from each utility within its jurisdiction an ERP for achieving a 20% reduction in its greenhouse gas emissions from 2005 levels by 2020.

I hereby direct GEO and the Department of Regulatory Agencies to identify regulatory and legislative changes that may be needed to provide the investor-owned utility with the appropriate incentives to reduce greenhouse gas emissions, and to reduce the financial barriers to investments in renewable energy sources, energy efficiency, carbon credits and clean coal technologies. The Executive Directors of these agencies will provide their suggestions to my office within 12 months of the date of this Executive Order.

We think that the assignment to the Department of Regulatory Agencies will be substantially assisted by our proposed investigation of utility incentives.

7. At the March 26, 2008 meeting we discussed a Staff recommendation to keep the methods used in the proceeding as flexible as possible including, but not limited to: Staff research, expert consultant research, Commission orders seeking comments, workshop presentations, and, to the extent allowable, individual discussions with parties of interest, as long as those discussions are fully disclosed to all interested parties. Since this proceeding is investigatory in nature, primarily focused on gathering information and will not impact any

current docket, the “permit, but disclose” approach is reasonable. In addition, Staff explained that the “permit, but disclose” discussions are often used by the Federal Energy Regulatory Commission and the Federal Communications Commission when investigating non-adjudicatory matters of interest before them.

8. We agree with Staff’s recommendation, and direct Staff to promptly begin the research phase (both Staff research and external resource research).

9. In addition, we invite interested parties to file comments in response to this order that address the appropriate scope of this inquiry, suggesting specific topics not covered in paragraph 5 above, and methods of inquiry. We are not seeking comments on the substance of the inquiry at this point; we anticipate that the Commission will issue subsequent orders in this docket requesting replies to specific questions we pose to interested parties.

10. Once Staff has an opportunity to review comments filed by interested persons, we direct Staff to initiate a dialogue involving the Commission, Staff, and all parties in interest addressing questions related to the impact of incentives on utility decision-making; and to schedule workshops and roundtable discussions as appropriate.

II. ORDER

A. The Commission Orders That:

1. An investigatory docket is opened concerning regulatory structures and incentives that influence electric and gas utility actions under existing regulatory structures in Colorado and concerning alternative incentives and alternative regulatory and rate structures that may alter or influence utility actions.

2. Staff of the Commission shall conduct this investigation pursuant to the authority vested in the Commission pursuant to Title 40, Articles 1 through 7 of the Colorado Revised Statutes.

3. Notice of this Order shall be provided to the public and to all interested parties.

4. Interested persons are encouraged to submit comments on the scope of the proceeding within 30 days of the Mailed Date of this Order. In addition to the filing of written comments, interested persons may submit comments electronically by compact disk (CD), or e-mail to puc@dora.state.co.us.

5. This Order is effective upon its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING
March 26, 2008.**

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioners